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The Voice of Small Business

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Small Business and the Michigan Economy

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My name is Charles Owens and I am the State Director for the National Federation of Independent Business, an organization providing legislative advocacy for almost 20,000 Michigan small businesses.

Thank you for this opportunity to come before the committee and discuss small business in the context of the current Michigan Economy. Let me begin by informing you that I am not an economist. I am a representative that advocates for small business in Michigan. In that role I have an opportunity to observe and interact with small business job providers from all corners of the state. In fact, in the last four weeks before this committee hearing I have attended local meetings in Grand Rapids, Jackson, Saginaw, Macomb, Livonia, Lansing, Petoskey, Sault Ste Marie and Escanaba with more than one hundred small business. The meetings are a reflection of our membership which, in turn, is a representative slice of Michigan small business. Service and manufacturing, farm and retail, construction and financial – NFIB membership cuts across all industry segments. NFIB determines its policy positions on issues by a direct survey or ballot of the membership. Therefore our positions reflect the opinions and concerns of the aforementioned representative slice of Michigan small business. Our positions may not always be popular, but to the satisfaction of our supporters and the annoyance of our critics, they are always an accurate snapshot of Michigan small business opinion. When this information is tempered with economic and research data, then policy makers have the opportunity to observe a clear vision of where small business would like the state to go in its pursuit of economic and tax policy in our state.

But why should policy makers care what small business thinks about our economy and our tax policy? The answer can be found from some Michigan statistics gleaned from data provided by the U.S. Small Business Administration:

- There were 742,600 small businesses in Michigan in 2003 including self employed businesses.
- Of the 210,803 businesses in Michigan with employees, 98.4 percent, or 207,400 were small (with fewer than 500 employees based on 2003 firm size data).
- 203,430 or 98.1 percent of those firms had less than 100 employees.
- In 2001, businesses with fewer than 500 workers employed 50.8 percent of the state's 4,008,570 non-farm sector employees.
- In 2001, businesses with fewer than 100 workers employed 36.1 percent of the state's 4,008,570 non-farm sector employees.
- In 2004, businesses in Michigan with less than 10 employees created 28,534 new jobs while businesses with more than 99 employees lost 68,178 jobs.

The answer is clear: while our state has been shedding jobs by the thousands, small business has been picking up the slack. This is nothing new to those of us who are familiar with the economic impact that small business has on our economy. If you were to look back into all of the other past economic ups and downs in the state and nation, the story would be the same: small business is the shock absorber on the economic roller coaster.

However, it might be news to many in the public policy arena who think that the answer to the jobs puzzle lies in continuing to throw money at big business and targeted industries instead of addressing the overall business climate of the state. If that were the only flaw in the state's approach to economic development, it would be more annoying than substantive in the overall scheme of things. The problem is that many believe that another answer is to restructure our business tax system to reward sectors that are shedding jobs by shifting taxes to those that create them. What's wrong with this picture?

The short answer is that such approaches are much easier than looking in the mirror and admitting that it is the state's overall tax and regulatory climate that needs revision. To tackle that problem takes a long-term view and tough leadership. If there is any doubt that our overall business climate is in need of review, take a look at a number of recently released studies that point out the clouds on our economic development horizon:

- The U.S. Economic Freedom Index, recently released by the Pacific Research Institute, in association with *Forbes* magazine. This index compares and ranks states based on over 100 variables, including taxes, state government spending, and regulations. The executive summary of the study can be found here: http://www.pacificresearch.org. With 1 being the best and 50 being the worst, Michigan is ranked 34.

- In the Washington DC based Tax Foundation's overall business climate index, Michigan ranked 36th out of 50 and in the category of corporate taxes our state ranked dead last.

- According to the Michigan *Small-Business Conditions*^{SM} report released on March 1 of this year, only a net 15 percent of the state's small employers (percent positive minus percent negative) believed business conditions in their market area are good while a net 16 percent characterized conditions as improving. Michigan's figures put the state last among the twenty-six states surveyed on business conditions. The new report's data provides an overview of small-business conditions within Michigan and compares them with neighboring and other large population states.

So where do we go from here? The good news is that the state has almost no where to go but up and small business continues to lead the way out of the difficult economic times in which we find ourselves. We have testified before in this committee and elsewhere that the twin sisters of job death are taxes and regulation. More than anything else, these two components determine a state's overall business climate. A positive influence on the business climate of a state is the focus on entrepreneurship or fostering an environment where business can grow and prosper. In that regard, we offer the following suggestions and guidelines to our policy makers as a good start in moving Michigan back on track:

Tax Policy

It has been observed many times before, but it bears repeating again, that our Single Business Tax has been the major culprit in sending a negative message to job providers both within and without our state. Although we have not taken a formal position on the governor's restructuring proposal (we will survey / ballot our members when we have more specifics on the plan) the response from our state-wide member meetings has been less than enthusiastic. Time and time again our members have indicated that the single business tax should be given a decent burial. A preview of the plan to our members at the aforementioned meetings (the "bullet points" from the governor's plan) yielded the following observations:

- Given our current economic conundrum, the litmus test for every tax proposal should be whether it will have a positive impact on job creation. Any analysis of this proposal we have seen has been lacking in this regard. In fact, in a February 4th MIRS article, treasury officials admitted that they were not able to determine if the proposal would create any new jobs. Policy makers should consider that revenue neutral as a goal for tax restructuring may also translate to "jobs neutral".

- Every prior single business tax change has lowered the tax for all or some in-state businesses without raising the tax on others. This proposal is the first to play one business sector off against another. This accomplishes two things: It creates divisiveness for the in-state business community, and it creates uncertainty for the out-state business community considering where to locate a business. Neither of these results are conducive to job creation or economic development.

- Although the goal of "revenue neutral" may be met in the initial year of the tax restructuring proposal, clearly this plan is designed to enhance revenue to the state in the long term. The message being sent by this facet of the proposal is that state government intends to continue to grow rather than stick to any long term budget reduction strategy or discipline.

Whether the proposal will be supported by small business or not remains to be seen, however, declarations that the plan represents a "bold approach" to solving Michigan's business climate problem are premature at best.

Past efforts by lawmakers to encourage small business development with changes to the single business tax have been a success and credit is due for your hard work. I refer specifically to the raising of the threshold to $350,000, the removal of payroll taxes (FICA, Work Comp, and Unemployment insurance) from the base and efforts to expand the opportunity to use the small business credit. Recent actions by the House to remove the cost of health insurance by 2006 are another step in the right direction and we encourage Senators to move that bill through the Senate in a timely fashion.

To return to the general issue of eliminating the single business tax, we would recommend a return to some kind of phase-out that was halted in previous sessions of the legislature. While some might consider this to be an unachievable goal because of our budget situation, I would direct them to observe the governor's end of the year press release were she outlined four major accomplishments of her administration including "making half a billion dollars available to attract entrepreneurs to the state". We would suggest that if the same amount of money were applied across the board rather than targeted to specific businesses or industries, we could lower the single business tax rate from 1.9 to 1.4 percent without any cost to the budget and without pitting segments of job providers against one another. Such a move would jump start a renewed phase out of the single business tax.

Regulations

In regulatory policy as in tax policy, any state that sticks out from the crowd (other states) in a negative manner is inviting trouble with its overall business climate. The single business tax is an example of this in tax policy. We are the only state that has it. It is not a welcome mat for new business. The same is true for regulations. When a state is the only state with a specific regulation or has taken a federal regulation and made it more stringent, the wrong message is often sent to potential job providers. Here are three specific examples of the potential for wrong direction on regulations:

SUTA Dumping – Unemployment Insurance Reforms: As the committee is aware, federal legislation requires us to take action on this important issue. Many have proposed legislation that goes beyond the federal requirements and makes our UI system less friendly than other state systems. It appears that the legislation will be passed along the lines of the federal model and guidelines and this committee and our lawmakers are to be commended for that. However, my point in bringing this up as an example is to illustrate how this can and does happen and how we have to be on guard with every proposed regulation.

Minimum Wage: Proposals have been put forth that would seek to raise Michigan's minimum wage above the current federal level that applies in all states. Rather than engage in a philosophy debate over the minimum wage, consider that in a state that has suffered as a poor business state in numerous rankings – do we really want to Michigan to "stick out" again from other states with a specific requirement that goes above the federal baseline? We would suggest not.

State Specific Ergonomics Regulations: After the federal government repealed its lumbering ergonomics mandate in 2001, the Michigan Occupational Safety and Health Administration (MIOSHA), is on track to adopt a costly, state-specific ergonomics rule. In a state that is shedding manufacturing jobs by the thousands, why should we be adopting a state specific set of rules that would adversely impact the manufacturing industry the most? The only state with a similar regulation is California. Washington State adopted it and it was repealed by ballot initiative. Once again, such an action does not throw out the welcome mat for job providers.

Entrepreneurship

Probably the most often used buzzword in economic development is the term "entrepreneurship" and fostering a climate where entrepreneurs are encouraged and rewarded. Many studies and presentations are given slicing and dicing data and dishing up road-show potions and remedies to grow entrepreneurship. Most of these proposed solutions involve showering grants, loans and tax breaks to chosen industries, start-up businesses, high tech and research and development businesses or whatever enterprise is currently in vogue. As was pointed out earlier in the discussion on the single business tax, collectively, the dollar value of all these narrowly crafted tax breaks add up to a price tag that would be better spent trying to lift all boats by applying the resources across the board to all Michigan businesses. The only institution that has consistently been right on which type of business or industry succeeds or fails (and by consequence creates or loses jobs) has been the market. But will overall tax climate changes be as effective as specific and scientifically targeted tax breaks? No, they will probably be more effective. Consider the March 2 release from the SBA Office of Advocacy, a copy of which will be included with this testimony and the headline which reads: "Reducing Marginal Tax Rates Increases Entrepreneurship, Study Shows". Here are some points from the study:

Tax Rates Directly Affect Entrepreneurial Entry, Duration, And Exit:

- A marginal tax rate reduction of one percent on entrepreneurial income increases the probability of entrepreneurial entry by 1.42 percent for single filers and 2.0 percent for married filers.

- A marginal tax rate reduction of one percent on entrepreneurial income decreased the probability of exiting entrepreneurial activity by 17.32 percent for single filers and by 7.81 percent for married filers.

- A marginal tax rate reduction of one percent on entrepreneurial income lengthens the duration of entrepreneurial activity by 32.5 percent for single filers and 44.8 percent for married filers.

- Higher marginal tax rates on wage-and-salary income also increase entrepreneurial activity as they provide incentives for workers to start their own businesses.

In summary, a great deal of energy and time can be saved by rethinking the economic development game and focusing on overall state tax and regulatory policy. The only segment of the economy that would suffer under this approach would be the cottage industry of economic development experts and consultants who play one state off against another and extract tax concessions for their specific clients.

Conclusion

Time does not allow a discussion of all taxes and regulations that adversely impact Michigan's business climate. In this presentation I have attempted to give you a picture of the important role small business plays in our state economy and provide some suggested direction to policy makers on how they can leverage the strength of small business to lead us out of our current predicament. I have also provided some examples and specific suggestions on a few of the major tax and regulatory hurdles we must overcome in order to put Michigan back on the map for job growth. I thank you for this opportunity and I look forward to working with you to make our state a better place for job providers and our citizens.

Attachments

SBA Office of Advocacy News Release March 2, 2005.
SBA 2004 Michigan Small Business Profile
NFIB Michigan *Small-Business Conditions*℠ report